

LUCIEN H. MERCIER  
1899-1962  
N. MEYER BAKER  
1909-1976

JOHN A. SANDERS  
ROBERT V. SCHNABEL \*\*  
ALLEN T. JOSEPH  
ROBERT D. POWELL \*\*  
DAN S. BRANDENBURG  
SUSAN PATRICIA FRANK  
ROBERT M. REINER \*  
RICHARD W. MILLER, JR. \*  
F. GREGORY McKENNA  
JOHN J. ABBENE

\* ALSO MEMBER OF MARYLAND STATE BAR  
\* ALSO MEMBER OF VIRGINIA STATE BAR  
\* ALSO MEMBER OF NEW YORK STATE BAR

SUITE 800  
730 FIFTEENTH STREET, N. W.  
WASHINGTON, D. C. 20005

(202) 638-2241  
CABLE: LUCMER  
TELEX: ITT440356

MARYLAND OFFICE  
SUITE 600  
51 MONROE STREET  
ROCKVILLE, MARYLAND 20850

M E M O R A N D U M

SUBJECT: Voluntary Employees' Beneficiary Associations—  
Tax Exempt Welfare Plans Under Section 501(c) (9)  
of the Internal Revenue Code

DATE: July 23, 1980

On July 17, 1980, the Internal Revenue Service published proposed regulations governing voluntary employees' beneficiary associations which are tax exempt welfare plans under Section 501(c) (9) of the Internal Revenue Code. Since we have a number of clients who have either adopted organizations of this type or may be considering organizations of this type, we have prepared a summary of those proposed regulations (copy of which is enclosed).

Proposed regulations generally do not have to be followed until they become final. They may also be subject to change.

The Internal Revenue Service will accept comments on the proposed regulations until September 15, 1980. If any of the proposed regulations have an adverse impact on your plans, you may wish to comment on them. Your comments should be mailed to: Commissioner of Internal Revenue, Attention: CC:LR:T:(EE-153-78), Washington, D.C. 20224. Should you desire it, we could make those comments on your behalf.

If we can be of any further assistance to you in this matter or should you have any questions regarding the proposed regulations, please do not hesitate to contact us. Regardless, if these regulations, when they become final, require an amendment of your documents or your administrative practices, we will be in contact with you.

We hope you find this summary helpful.

SANDERS, SCHNABEL, JOSEPH & POWELL, P.C.

Enclosure



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M E M O R A N D U M

TO: Clients of Sanders, Schnabel, Joseph & Powell, P.C.

FROM: SANDERS, SCHNABEL, JOSEPH & POWELL, P.C.

SUBJECT: Voluntary Employees' Beneficiary Associations — Tax  
Exempt Welfare Plans Under Section 5.01(c)(9) of the  
Internal Revenue Code

DATE: July 23, 1980

On Thursday, July 17, 1980, the Internal Revenue Service published proposed regulations for voluntary employees' beneficiary associations exempt from taxation under Section 501(c)(9) of the Internal Revenue Code, a copy of which is enclosed. The previously proposed regulations of January 23, 1969, were never finalized. To the extent that they impose more stringent requirements on existing tax exempt welfare plans than the regulations proposed on January 23, 1969, the new proposed regulations will only apply with respect to taxable years beginning after December 31, 1980. The balance of the new proposed regulations are effective for taxable years beginning after December 31, 1954. In the case of existing tax exempt welfare plans which receive contributions from one or more employers pursuant to one or more collective bargaining agreements in effect on December 31, 1980, the new proposed regulations shall apply to taxable years beginning after the date on which the agreement (or agreements) terminates. An existing tax exempt welfare plan may choose to be subject to all or a portion of one or more of the provisions of these regulations for any taxable year beginning after December 31, 1954.

There are four basic requirements in order to be a "voluntary employees' beneficiary association" listed in the proposed regulations. They are as follows:

- (a) The organization is an association of employees;
- (b) Membership in the organization is voluntary;

MEMORANDUM

From: Sanders, Schnabel, Joseph & Powell, P.C.

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(c) The purpose of the organization is to provide for the payment of life, sick, accident, or other benefits; and

(d) None of the organization's funds may inure to the benefit of any private shareholder or individual other than as contemplated by (c) above.

The membership of a tax exempt welfare plan must consist of individuals who are entitled to participate by reason of their employee status. There are three ways in which eligibility for membership in this type of plan is defined. The first is in reference to a common employer or affiliated group of employers. The second is with reference to employees in certain specified job classifications working for employers at specified locations and who are entitled to benefits pursuant to one or more collective bargaining agreements. The third would be employees of one or more employers engaged in the same line of business in the same geographic area whose employers provide benefits under a plan. The validity of the membership criteria is a question to be determined with regard to all the facts and circumstances surrounding the definition of the group. Up to ten percent of the members may be trustees, administrators, employees of the association, or the proprietor of a business whose employees are members of the plan.

Membership may be restricted by geographic proximity; by objective conditions; or limitations reasonably related to employment such as a reasonable classification of employees, a reasonable minimum period of service, limitations based upon maximum compensation, or a requirement that a member be employed on a full-time basis. Eligibility for benefits or membership may also be restricted by objective conditions relating to the type or amount of benefits offered. However, these restrictions can not be selected or administered in a manner that discriminates in favor of officers, shareholders, or highly compensated employees. The selection or administration of the objective conditions which have the effect of discriminating in favor of officers, shareholders, or highly compensated employees will be determined on the basis of all of the facts and circumstances surrounding the case. If the limitations are based upon one or more collective bargaining agreements they will generally be accepted as being reasonable. Membership may also be extended to dependents of employees, to employees who are on leaves of absence or temporarily working for another employer, or employees who have been terminated by reason of retirement, disability or layoff.

In order to be eligible for tax exempt status, the benefits must be funded through establishment of a trust or a corporation.

In general, membership in an association is considered voluntary if an affirmative act is required on the part of an employee to become a member; however, an employer may impose membership on the employees if the plan is

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noncontributory or if membership is required as a result of a collective bargaining agreement.

A major change in the new proposed regulations from the prior proposed regulations is that the employee members of a tax exempt welfare plan must have a voice in the control of the tax exempt welfare plan. Generally, such control will be deemed to be present when the membership either directly or through its representatives elects, appoints, or otherwise designates a person or persons to serve as chief operating officer, administrator or trustee of the organization. The proposed regulations seem to indicate that control by an independent trustee or trustees, even though not selected by employees, will satisfy this requirement; however, there is no explanation in the proposed regulations of the meaning of an independent trustee. This provision, to the best of our knowledge, has never been required before and would require, in our opinion, a change for almost all existing plans.

A tax exempt welfare plan may provide life, sick, accident, or other benefits similar to life, sick, or accident benefits if the benefit is intended to safeguard or improve the health of a member or a member's dependents or if it protects against a contingency that interrupts or impairs a member's earning power. Sick and accident benefits include disability benefits. The benefits provided by the tax exempt welfare plan may be funded through an insurance company or directly by the sponsors of the plan through the trust or corporation. Examples of nonqualifying benefits are: accident or homeowners insurance benefits for damage to property, provision for malpractice insurance, and provision for loans to members except in times of distress. A benefit which is similar to a pension or annuity payable at the time of mandatory or voluntary retirement is another example of a nonqualifying benefit if the benefit provides for deferred compensation that becomes payable by reason of the passage of time rather than as a result of an unanticipated event. This raises the question of the permissibility of disability benefits from a tax exempt welfare plan after retirement.

No part of the net earnings of a tax exempt welfare plan may inure to the benefit of any private shareholder or other individual other than through the payment of permissible benefits. The payment of unreasonable compensation to the trustees or employees of a tax exempt welfare plan or the purchase of insurance or services for amounts in excess of their fair market value from a company in which one or more of the association's trustees, officers or fiduciaries has an interest will be prohibited inurement. Whether prohibited inurement has occurred is a question to be determined with regard to all the facts and circumstances. Not only would prohibited inurement negatively affect a plan's tax exempt status, it may also be a prohibited transaction for purposes of the excise tax imposed on prohibited transactions and for purposes of civil liability. However, the proposed regulations expressly permit the rebate of excess insurance premiums to the payor of such premiums as a result of favorable experience.

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The controlling documents of the plan must provide that upon dissolution of the plan excess amounts will be distributed to the employee members of the plan and will not be returned to the employers. The regulations do not include any requirements regarding the types of annual information returns to be issued with respect to payments nor do they contain any provisions regarding the funding of these organizations. Taxability of the benefits will be subject to all of the other provisions of the Internal Revenue Code regarding taxability of welfare benefits.

The proposed regulations also provide, without stating any details, that a tax exempt welfare plan must maintain records indicating the amount contributed by each member and contributing employer and the amount and type of benefits paid by the organization to or on behalf of each member.

Enclosure

## ROUTING AND RECORD SHEET

SUBJECT: (Optional)

FROM:

Deputy Director of Personnel  
Policy, Planning, and Management

EXTENSION

6825

NO.

DATE

4 AUG 1980

TO: (Officer designation, room number, and building)

DATE

RECEIVED

FORWARDED

OFFICER'S  
INITIALS

COMMENTS (Number each comment to show from whom to whom. Draw a line across column after each comment.)

1. DD/SP

Dow:

You'd better get a fast ruling on whether this affects EAA, GEHA, EAF, PSAS and, if so, how and what do we have to do.

2.

3.

4.

STATINTL

5.

action to STATINTL  
to

6.

STATINTL

7.

8/5/80

8.

9.

~~SUSPENSE SP~~  
~~DUE - 21 Aug.~~

10.

11.

STATINTL

12.

13.

14.

15.

Billi  
will  
give us an  
answer no later  
than 15 Sept.  
Please tickle.  
How